Some Exclusive Revelations

Underside of Ike's Doctrine: How the Oil Companies It Protects Mulct the U. S. Treasury

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Where the Body Is Buried in That Aramco Tax-Scandal

I

Digging into the happy circumstances which enabled Aramco to make $280,000,000 in 1956 without paying a penny of U. S. income tax, I made a discovery. I obtained photostats of the official Arabic and English texts of the Saudi Arabian income tax decrees promulgated by Ibn Saud in 1950. These had been filed by the Arabian American Oil Company (Aramco) with the Internal Revenue Bureau here in Washington. The O'Mahoney monopoly subcommittee, which first disclosed Aramco's Elysian tax life, ought to subpena the Internal Revenue Bureau's file for itself. It will be surprised to learn that originally Ibn Saud's decrees contained a provision envisaging the possibility that Aramco might have to pay U. S. income taxes on its profits from Arabian oil. This provision (precisely and exotically, Article 2 of Royal Decree No. 17/2/28/7634/16 Rabia Al Awal 1370) allowed the company to deduct U. S. income taxes in arriving at the net income on which Ibn Saud would get his final 50-50 split.

That provision might have put many million of dollars into the U. S. Treasury. Unfortunately it was removed. If Senator O'Mahoney puts his investigators to work on it, he will find written alongside this Article 2 a notation by an unknown hand in ink, presumably that of an Internal Revenue Bureau official. This says, "removed from law in 1952 see page 4 of memo dated 4-16-54 from Aramco." I hope Senator O'Mahoney will ask the Internal Revenue Bureau for a copy of that 1954 memo and demand that Aramco explain just how Ibn Saud happened to change his tax decree in 1952.

The Man Who Drafted Those Decrees

The effect of the change was to make it harder for the U. S. to collect anything on the huge Arabian oil profits it spends so much to protect. How did the change happen to be made? Testimony already taken by the O'Mahoney subcommittee indicates that Aramco has paid no income taxes on its Arabian profits since those tax decrees of 1950. How did it manage to avoid paying income taxes during the two years when the Saudi Arabian law itself allowed U. S. income taxes as a deduction? One way to start on this aspect of the matter might be to subpena the man who drafted the tax decrees for Ibn Saud. He is John F. Greaney, a lawyer with offices in the Warner building in Washington, a man unknown to the general public but well known in the profession as an expert on the foreign tax credit problems of American corporations. He went to Saudi Arabia to draft those laws in 1950.

The discovery of the original decree and the handwritten notation shows that F. A. Davies, chairman of the board of Aramco, was less than frank with the O'Mahoney committee when he appeared as a witness before it on March 20. Mr. Davies was interrogated by Donald P. McHugh, chief counsel of the subcommittee, on the assumption that the original Saudi Arabian tax decree took 50 percent of the net profits without allowing for payment of U. S. income taxes. Mr. Davies did not correct this false assumption much less offer the original decrees in evidence. He said Ibn Saud was demanding a deal like that in Venezuela where the government's take of oil company profits had been raised to 50 percent of the net. Mr. McHugh asked Mr. Davies why the company didn't just raise the royalty payments to 50 percent of net. "That would have made our position out there pretty bad competitive wise," Mr. Davies replied, "and the Saudi Arabian government was insisting on an income tax which would result in no additional burden on the company." This insistence that Ibn Saud was worried about the company rather than his own profits shows a gift for humor on the part of the Aramco executive.

Other Evidence Available

There is other evidence that originally Aramco was not sure it could rid itself of U. S. income taxes by its 1950 agreement to split its profits with Ibn Saud. A relevant passage from page 128 of the famous Federal Trade Commission report on "The International Petroleum Cartel" was put into the record of the O'Mahoney committee hearings but its significance was not understood. The FTC report cites the annual reports for 1950 of the four constituent companies which own Aramco (Standard of N. J., Standard of Calif., Texas and Socony Mobil) as telling their stockholders that Aramco in 1950 "agreed to pay taxes up to but not exceeding 50 percent of its net profits, *after income taxes to the U. S. were deducted.*" (My italics).

What Ibn Saud did in 1950 was to issue two income tax decrees. The first, of November 4, imposed a general 5 percent tax on individuals and a 20 percent tax on the income from invested capital. The second decree, of December 27, imposed an additional income tax on petroleum companies in the Kingdom amounting to 50 percent of their net operating income. In figuring net operating income, the oil companies, i.e. Aramco, were allowed to deduct the amounts already paid under the general Saudi Arabian income tax and all other expenses, royalties and local taxes. They were also allowed, by Article 2, to deduct "Income taxes, if any, to the extent that such taxes have actually been paid by the company or are payable by it to any foreign country. . . ." Under this arrangement Aramco would have paid a 20 percent income tax to Saudi Arabia over and above its royalties, and then paid an income tax to the U. S. Treasury, and then split the remainder

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Did Herbert Hoover, Jr., Use A Tax Deal to Sweeten the Iranian Agreements...

with Ibn Saud. Instead, as the tax was finally worked out, nothing was paid to the U. S. Treasury.

The background of this tax scandal is the different way U. S. law treats income taxes paid abroad from income taxes paid at home. If a U. S. corporation pays an income tax in Idaho, it can deduct the amount before figuring the net on which it pays Federal income taxes. But if a U. S. corporation pays an income tax abroad, that amount becomes an offsetting credit against its Federal income tax bill, not just a deductible item. The difference is substantial.

Let us illustrate with an oversimplified example. Suppose the Federal income tax is 10 percent. A corporation earns $100 in Idaho. It also pays a $10 State income tax on this in Idaho. So it gets a deduction. The $10 is deducted from the $100 income and the corporation pays Federal income tax on $90. The Federal tax itself is thus reduced to $9. The $10 deduction results in a $1 saving on the tax bill.

But if the corporation earns $100 in Saudi Arabia and has paid a $10 income tax there, that $10 becomes an offsetting credit against its Federal income tax bill. The $10 credit for the tax in Saudi Arabia would offset the $10 owed the Federal government. No tax at all would be paid the Federal government. The difference between treating this $10 as a credit or a deductible item is the difference between paying nothing and paying $9.

Why Ibn Saud Grumbled

It was this tax loophole which Aramco seized upon when Ibn Saud in the late 40's began to grumble that he wasn't being paid enough for his oil. He could hardly be blamed for complaining. The 60-year exclusive concession he granted Aramco in 1933 fixed a royalty of 21 cents a barrel. In 1949 when the net profit by Aramco's own figures was $1.10 a barrel, Ibn Saud was still getting only 21 cents or less than 20 percent. Saudi Arabian oil was the century's biggest bonanza, and Ibn Saud wanted a bigger share of the profits.

But if Mr. Davies is to be believed, Ibn Saud's resentment was not against the company but against the U. S. Treasury. He testified, "They wanted more. They asked as early as 1948, 'Isn't there some way in which we can get a greater take?' and a little later than that they said, 'Isn't there some way in which the income tax you pay to the United States can be diverted to us in whole or in part?'." At another point Mr. Davies said, "You want to bear in mind, Mr. McHugh, I think it was in the year 1949 our income taxes to the United States were greater than the total take of Saudi Arabia out there from the venture, and they weren't a darn bit happy about it. . . . They felt that the U. S. was getting too big a percentage of the profits from the venture." The prize statement in this vein, however, came when Mr. Davies said self-righteously, almost the crusader against colonialism, "It is very difficult for many countries to realize why the U. S. should participate in the profits from the development of their natural resources." By U. S., of course, he meant only the U. S. Treasury.*

Earlier in 1950 the Internal Revenue Bureau had for the first time ruled that a 50 percent tax on petroleum companies could be treated as an income tax credit. This was in the case of Venezuela. Aramco may have feared that the Treasury would find differences between the situation in Venezuela and that in Saudi Arabia. Venezuela had long had an income tax on mining as well as petroleum. When the rate was raised to 50 percent of net it was no different from the 52 percent maximum on the net of corporations in this country. The Arabian situation was somewhat different. Digging around, I learned that the original concession agreement not only fixed the price at 21 cents a barrel but, looking shrewdly ahead, forbade the Arabian government to impose new and higher taxes on the oil company. Legally the company itself could decide whether it choose to pay a higher royalty or accept a higher income tax in place of a royalty. Practically it was in a powerful position since if Saudi Arabia nationalized the petroleum industry and took over the concession, it could not hope to refine, ship and market that oil against the wishes of the Standard Oil Companies.

Neither Sovereign Act nor Arm's Length Bargain

Thus the Treasury might have decided that the 50 percent income tax law in Saudi Arabia, unlike that in Venezuela, was not a genuine result of action by a sovereign power but a move decided by Aramco itself, a subterfuge to make the Treasury pay the whole cost of its increased payments to Ibn Saud. The term "whole cost" is used since if the increased payments had been in the form of an increased royalty, this would have been a deductible item. Aramco normally deducts the total amount of its royalty from its income and pays tax only on the remainder. Since the top rate is 52 percent, the Treasury would in effect have been paying 48 cents on every additional dollar paid Ibn Saud. But Aramco wasn't satisfied. They wanted to find a way to make the Treasury pay the full amount. They did this eventually by working out with Ibn Saud the scheme for a 50 percent income tax. The total amount of this would then become an allowable tax credit. In 1956, when Ibn Saud and Aramco split $280,000,000 between them, Aramco's share was tax free because it could apply the 50 percent Aramco tax as a dollar-for-dollar offset.

There is reason to believe that the top officials of the Treasury under both Truman and Eisenhower were queasy about this Arabian tax deal and that Aramco had difficulties in getting it approved. This is a matter on which the O'Mahoney committee could perform a great public service by investigating further, for this involves much more than Arabia. Aramco did not succeed in getting approval for the Arabian tax scheme until after Herbert Hoover, Jr., made a similar tax scheme part of the Iranian oil consortium agreement in September, 1954. The gossip in those small circles informed even meagerly on such highly technical and secretive matters is that Hoover got the White House to take a hand and force approval of such settlements. In effect the Iranian government, like the Saudi Arabian, was given an

* Contrast his reply when asked by Senator O'Mahoney how he felt about nationalization and whether he would expect the U.S. to defend Aramco against an attempt to nationalize. "I would certainly," Mr. Davies replied, "I think it is one thing to nationalize a business within a country purely for the welfare of the people of that country, and I think it is entirely different when an industry is nationalized which is operating in that country through a sacred concession agreement or a contract, and I don't believe it should be justified or condoned by the U.S. government. . . . I would like to see . . . that we have some kind of a recourse when some dictator or other ruler tells you that you're through. . . ."

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. . . And Get the White House to Overrule the U. S. Treasury's Qualms?

increased take at the expense of the U. S. government. In May, 1955, the Aramco deal was approved by Internal Revenue. Presumably similar arrangements benefit Standard of New Jersey and Socony Vacuum in their joint participation (a 23 percent interest) in Iraqi oil. Unfortunately they make no public reports on their Near East Development Company. The State Department is treating most of the Iranian agreements as classified. The amounts involved in Iran, Iraq, the Persian Gulf sheikdoms and Saudi Arabia may be costing the U. S. Treasury many times more than the $200,000,000 attached to the Eisenhower Doctrine.

What the public does not yet realize in this Year One of the Eisenhower Doctrine is that none of the oil company operations in the Middle East it is designed to protect are paying income taxes. All these companies are leading a tax-charmed life, and charging the U. S. the full amount of the increased payments necessary to keep happy the sheiks and potentates with whom they deal. They are in effect being subsidized by the U. S. Treasury. The private interests more responsible than any others for the huge and warlike Eisenhower budget not only escape their fair share of its burdens but have managed to shift some of their own to the back of the Treasury. This is the story which needs to be dug out and brought into the light of day.

II

In the excitement created by the revelation that Aramco was making close to $300,000,000 a year in Arabia without paying income taxes on it, certain other sections of the March 20 testimony were overlooked and it was assumed that the U. S. government was the unwitting victim of something cooked up at its expense by Ibn Saud and Aramco. But Mr. Davies in his testimony disclosed that the government was in on the preliminary discussions. When Mr. McHugh asked him, "Was there any consideration given previous to the promulgation of this decree concerning the upping of the royalty rate as against paying that money in the form of income tax?" Mr. Davies replied, "Considerations were given along every possible line. We discussed the matter among ourselves *and we also discussed it here in Washington,* and there was no alternative which was arrived at which would fulfill the desires of the Saudi Arabian government for this approximately 50-50 take which they knew Venezuela was getting."

Apparently Ibn Saud had also been visited by a U. S. Treasury representative. This came out while Mr. Davies was discussing Ibn Saud's efforts to get more revenue out of Aramco. "In the meantime," Mr. Davies said, "they [the Arabians] had been visited by a representative of the Treasury Department." Senator Carroll (*D. Col.*) was curious about the part this Treasury man played:

"Not That I Know Of"

Sen. Carroll: Did he [the Treasury representative] promulgate this [Saudi Arabian] income tax law which was passed?

Mr. Davies. No, he was there before this law was written.
Sen. Carroll. Did he participate in the conferences?
Mr. Davies. Not that I know of.
Sen. Carroll. Was he sent there to participate?
Mr. Davies. Not that I know of.

Senator Carroll wanted to know whether the State Department, too, had had a hand:

Sen. Carroll. Did you confer with the State Department on this income tax mechanism whereby Saudi Arabia would get funds and the U.S. Treasury would get nothing?
Mr. Davis. We conferred with the State Department.
Sen. Carroll. Did they approve it?
Mr. Davies. They did not approve it. They did not so far as I know disapprove it. They listened and appreciated, expressed an appreciation of the pressure we were under.

The Senator wanted to know with whom he had conferred. It was with George C. McGhee, then Assistant Secretary of State for Near Eastern and African Affairs. Mr. McGhee, it appeared from further questioning, is now in the oil business on his own.

When the afternoon session resumed (with George Wadsworth, Jr., the U. S. Ambassador to Saudi Arabia recorded as present), Mr. McHugh wanted to know more about what a U. S. Treasury representative—his name was George A. Eddy —was doing in Saudi Arabia. Mr. Davies said it was his "understanding that he was out there to confer with the Saudi Arabian government with respect to their fiscal policies."

Mr. McHugh: Which fiscal policies?
Mr. Davies: Of Saudi Arabia. Financing arrangements and so forth. Stabilization of their currencies.
Mr. McHugh. Did that involve the income tax decree?
Mr. Davies. I wouldn't think so.

By A Happy Coincidence . . .

When Mr. McHugh asked Mr. Davies whether he knew where "this Mr. Eddy," was, Mr. Davies answered, "Yes, I spoke to him here a little while ago. He is there on the other side of the room." Mr. Eddy was called to the stand.

The first impression given by Mr. Eddy is that he wasn't out there in connection with fiscal matters at all, but with monetary or currency problems. He said he was in Saudi Arabia in 1948 for six weeks and was sent out by the Treasury "to supply any help I could about their extraordinary and unique monetary problems." This sounded almost numismatic, as if he were going to study the ancient coins hung on the throats of the lovelier dancing girls in Mecca.

Then it appeared that for some reason Aramco was bashful about looking into these "monetary" problems. This was when Senator O'Mahoney wanted to know how the Treasury happened to send him out and he said he "believed" the Saudi Arabian government had asked for advice "and I do recall that the Arabian American Oil Company had recommended that some experts be sent out to help them because the company did not want to advise the country on that monetary policy area." This seemed unusually fastidious.*

Sen. O'Mahoney: Did you have anything to do with respect to Aramco at the time?
Mr. Eddy: Yes, sir, Aramco loomed very large in all of

*** It appears that the State Department also participated in this "monetary" study because later Mr. Eddy told Senator Wiley, "I don't recall who in the Department gave the final approval of going. Another man from State Department also went. I do know that Aramco wrote to Undersecretary Lovett of the State Department and possibly to Mr. Snyder but to someone in the Treasury and asked these departments to send a mission to Saudi Arabia to give advice on monetary problems."**

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That "One Brief Conversation" in Arabia Turned Out to Be Quite A Pow Wow

Saudi Arabia's problems and I did have several things to do with it, touched on Aramco's problems. . . .

Sen. O'Mahoney. Did you have anything to do with this income tax problem?

Mr. Eddy. A very little. There was one brief conversation which touched on this point.

So Mr. Eddy wasn't just matching coins for the Saudi Arabian government. But he was very diffident about this "one brief conversation." He was only a subordinate. He didn't know whether he was authorized to speak for the executive departments of government. Senator O'Mahoney said he would absolve the witness:

Mr. McHugh: Will you tell us, then, Mr. Eddy what if any discussions or advice was furnished by you to the Saudi Arabian government in connection with the drafting of the income tax law of Saudi Arabia?

Mr. Eddy. Nothing whatever on that, sir. So far as I know, any drafting of the law occurred a year or two after I had been in the country. I had no communications with the Saudi Arabian government on any drafting of any income tax law.

"Naturally, They Were Thinking of Aramco . . ."

This sounded pretty conclusive, but fortunately Mr. McHugh was persistent:

Mr. McHugh: Did you discuss with Saudi Arabian officials the question of establishing an income tax?

Mr. Eddy: There was one question that was asked me by a subordinate official, something to the effect: What kind of arrangements are there throughout the world by which the owners of oil bearing lands participate in the income from the production of oil?

Mr. McHugh: Did the question arise concerning the method whereby the Saudi Arabian government would share in the profits of Aramco, the question of royalties vs. an income tax?

Mr. Eddy. It was a general question not applied to any company in any wording of the question. But of course Saudi Arabia has just one oil producing company so naturally they were thinking of Aramco. But the question asked me and the answer I gave was wholly in very general terms without any company or any figures involved at all.

Obviously no company had to be named or no figures mentioned. But Mr. Eddy's further testimony shows he was well aware of what was involved. The conversation was not as brief and inconsequential as he first made it appear because he actually went to see the U. S. Ambassador for advice before answering the question! Let us listen in again at this point:

Mr. McHugh: Will you tell the Committee generally what the effect of your advice to them was on this question?

Mr. Eddy: By effect, I presume you mean the purport rather than the result. I don't know of the result and I have no idea whether anything I said had anything to do with the result. I had one conversation with a man who himself I believe was relieved of his position or resigned the next year. He asked me what kinds of arrangements owners of oil lands used.

I consulted with the U.S. Ambassador whether I should answer the question at all and he said I should, and then I went back to this official and said that I was by no means qualified to give him expert advice on that subject. I was trained in another area but so far as I knew there were several different arrangements. I cannot recall all the ones I named. One was a direct royalty. One was I believe a rental arrangement. One was a stock participation. One was an income tax, and there may have been several others, I can't recall now.

The Confession Eddy Added Later

So that "brief conversation" was quite a conference after all, interrupted by a trip to the U. S. Embassy for advice on whether to answer the question. It is interesting to notice that in his testimony he mentioned the income tax last, almost as an afterthought "and there may have been several others, I can't recall now."

And now I want to come to my final revelation, which underscores my belief that the committee has merely scratched the surface so far, that Mr. Eddy could tell the committee a lot more than he has.

Reading the official transcript in the subcommittee rooms, I found a sentence written in at the end of the answer by Mr. Eddy which I have just quoted. The additional sentence said, "I did explain to him the difference in the effect on the company between a royalty and an income tax." This sentence was added by Mr. Eddy himself when he turned up at the subcommittee several days after the hearing to read his own testimony. *Why was he afraid to let his testimony stand as given without this crucial admission?* What was the Treasury-State "monetary mission" to Saudi Arabia doing? Was it helping the Treasury? Or Aramco? This is where the body is buried.

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